United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

75-7100

To be argued by
MILTON S. ZEIBERG

B
P/S

United States Court of Appeals
FOR THE SECOND CIRCUIT

WILLIAM H. NOLAN, on behalf of himself and all others similarly situated,

Plaintiff-Appellant,

v.

RICHARD B. MEYER, CARL ANTENUCCI, STEVE NARKER, THOMAS WHITE, LESLIE C. KISSICK and MICHAEL N. SOTTILE, as Administrators and Trustees of the Profit Sharing Plan for the Employees of Merrill Lynch, Pierce, Fenner & Smith, Incorporated,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF PLAINTIFF-APPELLANT

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Question Presented for Review

Did the District Court have subject matter jurisdiction of plaintiff's claim based on federal common law?

Statement of the Case

A. Proceeding Below

This is an appeal from a judgment [59a]* which dismissed the complaint under F.R.Civ.P. Rule 12(b)(1) for lack of jurisdiction over the subject matter [53a].**

The complaint filed on August 23, 1974, in paragraph "TWELFTH" [6a] alleges a class action claim by plaintiff and members of the class similarly situated who: (a) are former employees of Merrill Lynch, Pierce, Fenner & Smith, Incorporated ("Merrill Lynch") and participants in its Employees' Profit Sharing Plan ("Plan"); (b) who voluntarily left their employment and joined a firm declared by the Administrators of the Plan to be in competition with Merrill Lynch; and, (c) whose profit-sharing benefits were declared forfeit for competitive employment.

Plaintiff seeks the relief herein adjudging and decreeing that the forfeiture provision of the Plan is void and unenforceable, and the plaintiff and each member of that class be awarded judgment against the defendants in the respective amount of the benefits declared forfeit for competitive employment.

The forfeiture clause of the Plan herein involved is Article 11.1 (5a; 39a) which provides:

> "Forfeiture of Benefits
>
> 11.1 A participant who, in the determination of the Committee, voluntarily terminates his employment with the Corporation or provokes his termination and engages in an occupation which is, in the determination of the Committee, competitive with the Corporation, or any affiliate or subsidiary thereof, shall

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* Before Hon. Harold R. Tyler.

** References with the suffix "a" are references to pages of the Appendix in accordance with Rule 30(e) of the Federal Rules of Appellate Procedure.

forfeit all rights to any benefits otherwise due or to become due from the Trust Fund with respect to units credited for fiscal years subsequent to the fiscal year ended December 30, 1960.''

The complaint in paragraph ''TWELFTH (a)'' [6a] presents the following issues in behalf of plaintiff and former employees of Merrill Lynch whose profit sharing benefits were declared forfeit for the reason that such employees voluntarily left Merrill Lynch and thereafter engaged in an occupation determined by the Administrators and Trustees to be in competition with Merrill Lynch:

''(i) whether forfeiture of the profit-sharing benefits for the reason stated in subparagraph (a) constitutes an unreasonable restraint of competition in violation of the legislative intent and public policy considerations of the Sherman Anti-Trust Act, 15 U.S.C.A. § 1, et seq.; the Internal Revenue Code of 1954, as amended, Subchapter D—Deferred Compensation, 26 U.S.C.A. § 401 et seq.; and, the Welfare and Pension Plans Disclosure Act, 29 U.S.C.A. § 301 et seq.

(ii) whether forfeiture for the reason stated in subparagraph (a) constitutes an unreasonable restraint against competition under the common law and exceeds the reasonable degree of protection necessary to protect the legitimate interest of the employer.

(iii) whether forfeiture of the profit-sharing benefits for the reason stated in subparagraph (a) enervates free competition in interstate commerce and unreasonably restrains without consideration the right of an average working man to earn his livelihood or exercise his calling in violation of the legislative intent and public policy considerations of the aforesaid statutes and the common law.

(iv) whether forfeiture of the profit-sharing benefits for the reason stated in subparagraph (a) under

profit-sharing plans qualified under the Internal Revenue Code of 1954, as amended, Sub-chapter D—Deferred Compensation, 26 U.S.C.A. § 401 et seq. are affected by a national public interest and such forfeiture violates the statutory intent that such benefits be for the 'exclusive benefit' of employees.

(v) whether forfeiture of the beneficial interests of the Plan for the reason stated in sub-paragraph (a) result in an unjust enrichment to others.

(vi) whether the profit-sharing benefits referred to in the Plan are additional compensation in consideration of the services rendered.

(vii) whether forfeiture of the profit-sharing benefits for the reason stated in subparagraph (a) constitute an unenforceable penalty under the common law."

The complaint in paragraph "First" [2a] alleges that jurisdiction is founded on diversity of citizenship and amount and upon the existence of a federal question based upon the Sherman Anti-Trust Act, 15 U.S.C.A. § 1, et seq.; the Internal Revenue Code of 1954, as amended, Subchapter D—Deferred Compensation, 26 U.S.C.A. § 401, et seq., the Welfare and Pension Plans Disclosure Act, 29 U.S.C.A. § 301, et seq., and upon the principle of pendent jurisdiction. Paragraph "Seventh" [4a] and "Thirteenth" [10a] allege that the forfeiture clause violates the legislative intent and public policy considerations of said statutes as well as the common law.

Defendants' moved to dismiss the complaint on September 18, 1974 [14a] pursuant to F.R. Civ. P. Rule 12(b)(1) and Rule 12(b)(6) on grounds that the complaint fails to state a claim upon which relief can be granted and that the Court lacks jurisdiction over the subject matter in that no federal question is presented and there is no complete diversity of citizenship. Defendants sub-

mitted three affidavits in support of the motion, the first, by a defendant Administrator, Carl Antenucci [16a], stating that he was a resident of the State of New Jersey which was the same state of residence of the plaintiff [3a, 3b]; the second, by another defendant Administrator, Steven R. Narker [18a], stating he was Secretary of the Plan and annexing a copy of the Plan; and, the third, by Thomas J. Mullaney, Esq., of counsel to defendants [20a] which made reference to an action entitled *"Smith v. Meyer, et al."* in the Supreme Court, New York County, decided in the New York Court of Appeals on June 6, 1974. Defendant's motion, and a cross-motion by plaintiff to add and drop parties (for the purpose of preserving a timely Sherman Act claim and diversity jurisdiction), came on to be argued on November 8, 1974.

On the oral argument, plaintiff withdrew the cross-motion [54a] and submitted its opposition to defendants' motion as to original subject matter jurisdiction and sufficiency solely as a matter of federal common law. On January 14, 1975, the District Court rendered its opinion [53a] dismissing the complaint for lack of subject matter jurisdiction.

B. The Facts

The plaintiff, William H. Nolan, a citizen of the State of New Jersey, was employed by Merrill Lynch from 1957 to 1968 as an account executive (registered representative). During this period, he accumulated about $16,000.00 in benefits under the Plan.

In 1968, he voluntarily resigned his employment and became employed by another New York Stock Exchange firm. The Administrators declared these benefits forfeit under Article 11.1 of the Plan for competitive employment. (Complaint, pars. "FIFTH" and "ELEVENTH") [3a, 6a]. Except for the declaration of forfeiture, the plaintiff

would have been entitled to receive his benefits in full under Article 7.1(g) of the Plan [35a]. On about October 15, 1968, defendants paid to the plaintiff the benefits due up to December 30, 1960 (Complaint, par. "ELEVENTH"; Plan, Article 7.1(b) and (11) [6a, 35a, 39a]. The Plan* also provides that it is non-contributory (Plan, Article 2.1) [26a], and forfeited benefits are re-allocated among continuing participants. (Plan, Article 4.7) [312]. Defendants' Memorandum below stated "there is no dispute over the basic allegations of the complaint."

C. Source and Over-Riding Federal Concern of the Subject Matter and the Persons Affected

In the first instance, a federally qualified profit-sharing plan is created as a trust under a federal statute, 26 U.S.C.A. § 401, *et seq.* (Plan, Article 2.2(d)) [27a] and is administered by the Internal Revenue Service. That statute states the trust is created for the "exclusive benefit" of the employees, and it must be impossible at any time for the benefits to be diverted from that purpose. Another federal statute, 29 U.S.C.A. § 301, *et seq.* The Welfare and Pension Plans Disclosure Act of 1958, administered by the Department of Labor, provides for disclosure of information by employers to the Department for the benefit of employees. The *findings and policy* of that Act, stated in § 301, is that

> ". . . the continued well-being and security of millions of employees and their dependents are directly affected by these plans . . . and [the plans] are affected with a national public interest * * *; [that

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* Defendants' Memorandum below indicated that "contributions were discontinued and a distribution of the corpus thereof was made to eligible participants on April 30, 1973." The undisputed facts also show that defendants did not distribute a reserve fund of $4,400,000.00 established for all contingencies and to defray legal and other costs.

they] have become an important factor in commerce because of the interstate character of their activities, and of the activities of their participants."

Congressional concern with the subject matter of profit-sharing plans is manifest in the Committee hearings conducted in the House of Representatives and Senate during the 92d Congress (1971-1972) and the 93rd Congress (1973-74).[1] The Congressional hearings revealed the existence of a number of abuses, not the least of which was that employees "lose their benefits" as a result of unduly restrictive foreiture provisions.[2] These widespread plans have been equated with the expectancy of Social Security benefits.

The report of the Committee on Education and Labor of the House of Representatives, Report No. 93-353 of the 93d Cong., 1st Sess. (Addendum), stated that its studies showed that over 30 million employees, or almost one-half of the private non-farm work force, are affected by private pension and profit-sharing plans, and that the assets of private plans estimated to be in excess of $150 billion constitute the only large accumulation of funds which have escaped the imprimatur of effective federal legislation.

The 93d Congress on September 2, 1974 enacted the Pension Reform Act of 1974, 29 U.S.C.A. § 1001, which amended and modified the provisions of the 1954 Internal Revenue Code and the 1958 disclosure act into a S.E.C.-

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[1] House Subcom. on Labor of the Comm. on Education and Labor, Interim Staff Rep. of Activities of the Pension Study Task Force, 92d Cong. 2d Sess. (April 1972); Senate Comm. on Labor and Public Welfare, Rep. No. 92-1150, 92d Cong., 2d Sess. (September 1972) (accompanying S.3598); Sen. Comm. on Labor Public Welfare, Rep. No. 93-127, 93d Cong., 1st Sess. (April 1973) (accompanying S.4); and Senate Comm. on Finance, Rep. No. 93-383, 93d Cong., 1st Sess. (August 1973) (accompanying S.1179).

[2] Senate Comm. on Finance, Report No. 93-383, 93rd Cong., 1st Sess. (August 1973) (accompanying S.1179), at page 1.

type comprehensive federal statute regulating pension and profit-sharing plans. The 1974 Act decisively manifested the continued Congressional concern with the subject matter. There should be no doubt that the range of the Congressional intent was that profit-sharing plans are overriding federal subject matter and that they always were.

The magnitude of the national involvement in these Plans is reflected in a Study conducted by the Bankers Trust Company (1973), entitled "The Private Pension Controversy", where in developing the history of these plans in America, it is stated at page 9:

> "From 1950 to the end of 1970 the total number of active wage and salary workers covered under the system more than tripled. The number of pensioners rose more than tenfold, reflecting the gradual maturing of established plans. And aggregate benefits paid annually increased about 20 times! Thus, by the end of 1970, the total number of workers covered had reached 29.7 million, or 48.3 per cent of the private industrial labor force. The number of pensioners grew to 4.7 million. During the same period benefits paid annually rose to $7.4 billion, and total assets reached $137 billion."

The Bankers Trust Company Study traced the development of these Plans on a national level from their beginnings in the late 19th Century in the railroads and closely allied industries to the enactment of the first exemption of profit-sharing trusts from taxation in 1921, the enactment of the Civil Service Retirement Act providing coverage for federal civil employees in 1921, the passage of the Social Security Act of 1935, the decision in the Inland Steel Case in 1949 by the Supreme Court, affirming that a pension plan was an appropriate subject for collective bargaining, to the Labor Management Relations Act of 1958. That Study manifests the specialized national concern with

employee benefit plans and the on-going Congressional concern with the subject matter of their administration in interstate commerce.

The Plan at Bar affected 5,700 registered representatives employed by Merrill Lynch in 198 branch offices throughout the United States. (Merrill Lynch Prospectus, dated September 13, 1972, page 2 filed with the Securities and Exchange Commission). The New York Stock Exchange Directory for 1969 indicated that Merrill Lynch operated offices in 35 states and the District of Columbia.

D. Summary of Background Profit-Sharing Forfeiture Cases

The principal cases relevant to the background issues regarding forfeiture of profit-sharing benefits for competitive employment are as follows:

a. *Ware* v. *Merrill Lynch,* 2 Cal. App. 3d 35; 100 Cal. Rptr. 791, *aff'd* 414 U.S. 117 (1973). In *Ware,* the forfeiture clause of the instant Plan, Article 11.1 was declared void and unenforceable as a restraint of trade as a matter of law under a California anti-trust statute. That decision was affirmed by the Supreme Court on an appeal by Merrill Lynch which argued that compulsory arbitration rule adopted under the registration of the New York Stock Exchange pursuant to the 1934 Securities Exchange Act pre-empted a California statute which prohibited arbitration of a wage dispute. The Supreme Court, *inter alia,* held (p. 135) there is nothing in the securities act or S.E.C. regulations which specified arbitration as the favored means of resolving employer-employee disputes, nor that arbitration result in investor protection.

b. *Kristt* v. *Whelan,* 4 App. Div. 2nd 195, 164 N.Y.S. 2d 239 (1st Department, 1957), aff'd without opinion, 5 N.Y. 2d 807, 181 N.Y.S. 2d 205 (1958); *Austin* v. *House of Vision, Inc.,* 404 F.2d 401 (7th Circ., 1968); *Graham* v. *Hudgins Thompson Ball & Associates, Inc.,* 319 F. Supp. 1335 (N.D. Okla., 1970); and *Rochester Corp.* v. *Rochester,*

450 F.2d 118 (4th Cir., 1971), are cases which have adhered to an "employee-choice doctrine" which provides that profit-sharing benefits may be declared forfeit for competitive employment for the reason that such benefits are gratuities of the employer, and that reasonableness of restraint is not a factor to be considered because the employee has a choice of remaining with the employer and retaining the benefits, or leaving and forfeiting them, nor is such forfeiture a violation of any anti-trust statute.

c. *Inland Steel Company* v. *N.L.R.B.*, 170 F.2d 247, 253 (7th Circ. 1948), 12 A.L.R. 2d 240, *cert. den.*, 336 U.S. 960, 69 S.Ct. 887, 93 L.Ed. 1112 (1949). In this case it was held that under the National Labor Relations Act, Congress clearly considered in connection with the purpose of that Act that employee benefit plans are additional compensation and as much a part of an employee's wages as the money paid him at the time of the rendition of his services.

d. *Smith* v. *Meyer, et al.*, 357 N.Y.S. 2d 586 (complaint dismissed on basis of *Kristt* v. *Whelan*); *aff'd* 44 A.D. 2d 778, 355 N.Y.S. 2d 314 (1st Dept. 1974), a New York state class action brought in 1973 for a declaration that the forfeiture clause of the instant Plan was void and unenforceable as a violation of the New York State anti-trust statute, the Donnelly Act (General Business Law, § 340). Plaintiff in *Smith* argued that the earlier decision in *Kristt* v. *Whelan, supra,* upholding the "employee choice doctrine" was infirm for two basic reasons: (i) that it was well-established that profit-sharing benefits were not gifts, but additional compensation; and (ii), that restraint for competitive employment be measured in terms of reasonableness, i.e., the legitimate interest of the employer to be protected. Plaintiff's application for leave to appeal to the Court of Appeals was denied on June 6, 1974.

e. *Bradford* v. *The New York Times*, 501 F.2d 51 (2d Circ., 1974). The decision in this case was handed down on June 21, 1974. The case involved the forfeiture of

profit-sharing benefits by the No. 2 executive of the New York Times for competitive employment. The Court dismissed the Sherman Act claim asserted, but in construing a pendent claim under New York Law, struck down the "employee-choice doctrine" of *Kristt* v. *Whelan, supra,* by holding at 501 F.2d 51 at page 57:

> "We do not agree that *Kristt* represents the law of the state, if it be construed to eliminate any inquiry into reasonableness because of some purported doctrine of 'employee choice.' The inquiry remains whether or not the restraint was reasonable and the contract was breached."

In *Bradford,* the Court held that the restraint was reasonable for a number of reasons including plaintiff's possession of confidential communications and trade secrets, an agreement to remain as a consultant to defendant, and, that the employee was in the category of special, unique and extraordinary. The Court also indicated, *inter alia,* that the setting a fixed amount for any breach irrespective of its gravity or the probable damage to be contemplated, might well classify the clause as an unenforceable penalty.

E. Summary of the Plaintiff's Case

By this action, plaintiff seeks a declaration that the clause in the Plan providing for forfeiture of benefits for competitive employment without geographic or time limitation, (a) is void and unenforceable, as an unreasonable restraint upon competition which exceeds the degree of protection reasonably necessary to protect the legitimate interests of the employer, and (b) constitutes an unlawful penalty, applying the inquiry into reasonableness rule of *Bradford* v. *New York Times* as a rule of federal common law.

ARGUMENT

I

The District Court erred in dismissing the complaint for lack of jurisdiction on the basis of *Barlow* v. *Marriott*.

This point and the subheadings are respectfully addressed to plaintiff's argument of error below, and the authorities which substantially support the application of federal common law as the substantive law to be applied herein, and its basis for original subject matter jurisdiction.

A. The Application of Federal Common Law

The Constitution, Article III, § 2, provides "the judicial power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States . . ."

In *Ivy Broadcasting Co., Inc.* v. *American Telephone & Telegraph, et al.*, 391 F.2d 486 (2d Circ., 1968), it was held that a cause of action "arises under federal law" if the dispositive issues stated in the complaint require the application of federal common law. The pivotal question considered was whether a claim in breach of contract and negligence for telephone services presented an issue of federal common law as original subject matter jurisdiction.

In *Ivy*, the complaint alleged a claim in contract and negligence against the defendant telephone company(ies) claiming defendant(s) were grossly negligent and had unreasonably delayed installation and testing of telephone lines for the transmission of plaintiff's broadcasts as well as that defendants were also grossly negligent in the operation of those lines which resulted in noise, interruptions, and the transmission of wrong material. The complaint sought compensatory and punitive damages. There was no diversity of citizenship, nor did the operative federal

statute, the Communications Act of 1934, 47 U.S.C.A. § 151, provide a civil remedy for damages for negligence or for breach of contract by a communications common carrier.

In 391 F.2d at 488, this Court stated that the appeal presented a question—apparently of first impression—whether in the absence of diversity of citizenship, a federal court had jurisdiction over a claim for negligence and breach of contract in the rendition of interstate telephone service by carriers regulated under the Communications Act of 1934 and over counterclaims for unpaid charges with respect to such service.

After indicating that the Communications Act does not expressly grant a direct remedy nor should a remedy be inferred from that Act, this Court stated at page 490:

> "The question remains whether plaintiff's claims are governed by federal common law, and if so, whether the District Court has jurisdiction under 28 U.S.C. § 1331."
>
> "In the absence of any statutory provision relating to a carrier's liability for negligence or breach of contract, the Courts must determine whether these questions should be left to state law or whether the federal interest in the result of such cases is so great that they should be controlled by federal common law. See *Clearfield Trust Co.* v. *United States,* 318 U.S. 363, 63 S.Ct. 573, 8 L.Ed. 838 (1943)."
>
> * * *
>
> ". . . The question then is whether the federal statutory scheme for the regulation of interstate service indicates a Congressional policy requiring that the duties and liabilities under contracts for the provision of such service be determined according to federal rules in order to assure uniformity of rates and service."

The Court further held that it seemed reasonable that the Congressional purpose of uniformity and equality of rates should also be taken to apply to uniformity and equality of service, and that where neither the Communications Act itself, nor the tariffs filed pursuant to the Act, dealt with that particular question, a uniform rule of federal common law should be applied.

At 391 F.2d at page 492, the Court concluded:

> "Having determined that plaintiff's claims are controlled by federal law, we then reach the question whether a cause of action governed by federal common law arises under the laws of the United States within the meaning of 28 U.S.C. § 1331, thus giving concurrent jurisdiction to the district courts provided the amount in controversy exceeds $10,000. A case may 'arise under' federal law, even though the claim is created by state law, if the complaint discloses a need for the interpretation of an act of Congress. Smith v. Kansas City Title & Trust Co., 255 U.S. 180, 41 S.Ct. 243, 65 L.Ed. 577 (1921); see De Sylva v. Ballentine, 351 U.S. 570, 76 S.Ct. 974, 100 L.Ed. 1415 (1956). We believe that a cause of action similarly 'arises under' federal law if the dispositive issues stated in the complaint require the application of federal common law, a conclusion which we have intimated in prior decisions. See Port Authority Bondholders Protective Committee v. Port of New York Authority, 387 F.2d 259 (2 Cir., Nov. 19, 1967); McFaddin Express, Inc. v. Adley Corp., 2 Cir., 346 F.2d 424, 426-427 (1965), cert. denied, 382 U.S. 1026, 86 S. Ct. 643, 15 L.Ed.2d 539 (1966); cf. T. B. Harms Co. v. Eliscu, 2 Circ., 339 F.2d 823, 828 (1964). The word 'laws' in § 1331 should be construed to include laws created by federal judicial decisions as well as by congressional legislation."

In *State of Illinois* v. *City of Milwaukee, et al.*, 406 U.S. 91, 92 S. Ct. 1385, 31 L. Ed. 712 (1972), the pivotol question

considered was whether a claim to abate a nuisance by pollution of interstate waters was an action "arising under the Laws" of the United States within the meaning of 28 U.S.C.A. § 1331(a) which would confer original jurisdiction in the federal courts. The Supreme Court answered that question in the affirmative. Original jurisdiction was claimed in the Supreme Court as an action between states, but was not granted, and the parties were remitted to an appropriate federal district court. The Supreme Court held that notwithstanding lack of a civil remedy under any of the federal statutes relating to interstate waters, original federal subject matter jurisdiction existed for the claim, and that the federal common law would be applied.

The Supreme Court in 406 U.S. at page 98 stated:

> "The considerable interests involved in the purity of interstate waters would seem to put beyond question the jurisdictional amount provided in § 1331(a). See Glenwood Light & Water Co. v. Mutual Light, Heat & Power Co., 239 US 121, 60 L Ed 174, 36 S Ct 30; Mississippi & Missouri R. Co. v. Ward, 2 Black 485, 492, 17 L Ed 311, Co., 116 F2d 604, 606; C. Wright, The Law of Federal Courts 117-119 (2d ed 1970); Note, 73 Harv L Rev 1369.
>
> The question is whether pollution of interstate or navigable waters creates actions arising under the 'laws' of the United States within the meaning of § 1331(a). We hold that it does; and we also hold that § 1331(a) includes suits brought by a State.
>
> Mr. Justice Brennan, speaking for the four members of this Court in Romero v. International Terminal Operating Co., 358 US 354, 393, 3 L Ed 2d 368, 394, 79 S Ct 468 (dissenting and concurring), who reached the issue, concluded that 'laws,' within the meaning of § 1331(a), embraced claims founded on federal common law:
>
> 'The contention cannot be accepted that since petitioner's rights are judicially defined, they are not

created by "the laws . . . of the United States" within the meaning of § 1331 . . . . In another context, that of state law, this Court has recognized that the statutory word "laws" includes court decisions. The converse situation is presented here in that federal courts have an extensive responsibility of fashioning rules of substantive law . . . . These rules are as fully "laws" of the United States as if they had been enacted by Congress.' (Citations omitted.)

Lower courts have reached the same conclusion. See, e.g., Murphy v. Colonial Federal Savings & Loan Assn., 388 F2d 609, 611-612 (CA2 1967); Stokes v. Adair, 265 F2d 662 (CA4 1959); Mater v. Holley, 200 F2d 123 (CA5 1952); American Law Institute, Study of the Division of Jurisdiction Between State and Federal Courts 180-182 (1969)."

Judge Harvey M. Johnsen in *State of Texas* v. *Parkey*, 441 F2d, 236, 240 stated the controlling principle:

"As the field of federal common law has been given necessary expansion into matters of federal concern and relationship (where no applicable federal statute exists, as there does not here), the ecological rights of a State in the improper impairment of them from sources outside the State's own territory, now would and should, we think, be held to be a matter having basis and standard in federal common law and so directly constituting a question arising under the laws of the United States."

The Supreme Court cited numerous federal statutes which Congress had enacted dealing upon the subject matter of interstate waters, and concluded in 406 U.S. 103:

"The remedy sought by Illinois is not within the precise scope of remedies prescribed by Congress. Yet the remedies which Congress provides are not necessarily the only federal remedies available. 'It is not

> uncommon for federal courts to fashion federal law where federal rights are concerned.' Textile Workers v Lincoln Mills, 353 US 448, 457, 1 L Ed 2d 972, 981, 77 S Ct 912. When we deal with air and water in their ambient or interstate aspects, there is a federal common law."

Federal common law has been held applicable in numerous areas of federal concern in which the subject matter involved federal regulation, but Congress had not provided an express civil remedy.

In *Textile Workers Union* v. *Lincoln Mills,* 353 U.S. 448, 77 S. Ct. 912, 1 L.Ed. 972 (1957), the question presented was what substantive law was to be applied in suits under § 301 of The Labor Management Relations Act of 1957, 29 U.S.C.A. § 185. Jurisdiction was founded in that Act. The Act did not provide a civil remedy. The Supreme Court concluded that the substantive law to apply in suits under § 301 was federal common law.

In *Francis* v. *Southern Pacific Railway,* 333 U.S. 445, 68 S. Ct. 611, 92 L. Ed. 793 (1948), a wrongful death action of an interstate passenger riding on a railroad-employees free pass. Jurisdiction was based on diversity. The plaintiff sought the application of the Utah state common law on the basis that the accident occurred in that state. The Supreme Court held that federal common law would apply since there was a federal statutory scheme and extensive federal regulation governing free railroad passes.

In *Urie* v. *Thompson,* 337 U.S. 163, 69 S. Ct. 1018, 93 L. Ed. 1282 (1948), it was held that where the Federal Employers Liability Act was silent as to the definition of the term "negligence", federal decisional law would be formulated and applied, and that what constituted negligence was a federal question not varying in accordance with the different conceptions of negligence applicable under state or local law for other purposes.

In *Bowles* v. *Farmers National Bank,* 147 F. 2d 425 (6th Circ., 1945), it was held that federal common law would apply over the subject matter of a penalty in a banking transaction because the subject matter involved statutes with federal sources. In *D'Oench, Duhme & Co.* v. *Federal Deposit Insurance Corporation,* 315 U.S. 447 (1942), federal common law was applied to the subject matter of an accommodation maker to a note in a suit brought by a federal agency to which the note has been assigned.

Plaintiff respectfully submits that the *specialized Congressional statutory scheme* relating to profit-sharing plans represents as significant or great a federal subject matter as that in which federal common law was held to apply in the foregoing cited cases, and perhaps of more significance because the subject matter involves freedom from restraint of employment in interstate commerce within the shadow of constitutional liberties. The instant Plan is a singular document, created under federal law, regulated by federal agencies, and affecting as it did, about 5,700 persons in 35 states and the District of Columbia.

It is respectfully submitted that federal public policy considerations do manifestly apply to these plans as evidenced by the overriding federal concern herein expressed, *supra,* and to this Plan in particular, by reason of the magnitude of the persons affected in interstate commerce.

B. Argument of Error in the Opinion of the District Court Which Dismissed the Complaint for Lack of Jurisdiction

It is respectfully submitted that the District Court erred in determining the issue of jurisdiction on the basis of *Barlow* v. *Marriott Corporation,* 328 F. Supp. 624 (D.C. Md., 1971) and *Lieberman* v. *Cooke,* 343 F. Supp. 558 (D.C., E.D., Pa., 1972).

(i) *Ivy Broadcasting, Not Barlow, Is Pivotal to the Issue of Federal Common Law Jurisdiction*

In *Barlow,* former employees of a contributory plan brought an action in a District Court to recover their benefits and predicated jurisdiction on the Internal Revenue Code, 26 U.S.C.A. § 401(a)(4). Plaintiffs claimed that defendants had amended the plan to eliminate or pare down their benefits and the amendment discriminated in favor of officers and highly paid personnel. Plaintiffs alleged that the amendment constituted a breach of trust, disqualified the plan for a tax deduction, and the employer had an obligation to continue the plan in force and effect for the tax benefits of that statute, and their federal rights under § 401 were thereby violated. The District Court dismissed the complaint on defendant's motion under F.R. Civ.P. Rule 12(b) for lack of jurisdiction, holding that the Internal Revenue Code did not compel the employer to continue the plan, nor did it provide that a discriminatory amendment was unlawful, but that a violation of the Code merely resulted in loss of tax benefits to the employer. Thus, plaintiffs had no federally created rights and their claim lacked jurisdiction under the Code.

The Court in *Barlow,* made reference to the article by Professor Mishkin, "The Federal 'Question' in the District Courts," 53 Col. L.Rev. 157 (1953) which indicated that pragmatic considerations strongly militate against the acceptance of jurisdiction merely because the parties may have contemplated the availability of tax benefits, and concluded that under those circumstances the plaintiffs did not have a substantial claim founded directly upon federal law.

At bar, the District Court quoted the latter statement, and reached the same conclusion holding *Barlow* persuasive for the very same reason [56a]. There is, however, a clear distinction between the nature of the jurisdictional claim herein and the one made in *Barlow* which renders that statement inapplicable. Most significantly, this action bases

jurisdiction upon a claim in federal common law, and not upon a federal statute. As indicated, *Barlow's* plaintiffs founded jurisdiction directly on a federal statute.

The District Court herein, in its opinion, refers to pages 22-23 and 25 of plaintiff's Memorandum below [55a]. It was there submitted ". . . Neither Act [the Internal Revenue Code and the Welfare and Pension Plans Disclosure Act] provides a civil remedy, and it is not the purpose of the Complaint to allege such a statutory claim." This action does not claim that the trustees have a legal duty to continue the Plan, or that the Plan is disqualified for a tax deduction under § 401 because of an improper amendment. The claim herein is essentially that the forfeiture clause for competitive employment of the Plan violates federal common law because it unreasonably restrains competition in interstate commerce; and, in the highly specialized federal area of qualified profit-sharing plans there is original federal subject matter jurisdiction of this federal common law claim.

In this pragmatic context, the statement made in Professor Mishkin's article at p. 165, is more meaningful:

> "The *first* formulation of the requirement developed by the courts is that the plaintiff must be contending that a federally ordained rule specifically creates his cause of action. Any national source will suffice, whether Constitution, treaty or law. Indeed, he need not maintain even that some piece of national legislation provides, in so many words, the governing rule of substance; *if it is his position that his right to relief is granted by federal common law, whether in connection with a statute or otherwise, jurisdiction in the national trial courts will be supported.*" (Emphasis added)

See also, Moore's Federal Practice, Volume 1, § 0.60[8.3], at page 631, citing *Bell* v. *Hood*, 327 U.S. 678, 90 L.Ed. 939,

66 S.Ct. 773 (1946), which states that where plaintiff's claim relies on federal law, jurisdiction is well-founded.

In *Ivy Broadcasting, supra,* this Court held federal common law was the basis of original jurisdiction. As indicated, the subject matter was a claim for breach of contract and negligence involving telephone service. There was no diversity. *Ivy Broadcasting* was a case of first impression. In reversing the District Court which had dismissed the complaint for lack of jurisdiction, the Court, in 391 F.2d at p. 492, held:

> ". . . We believe that a cause of action similarly 'arises under' federal law if the dispositive issues stated in the complaint require the application of federal common law."

Plaintiff respectfully submits the issue of federal common law jurisdiction presented herein pivots on *Ivy Broadcasting,* not *Barlow,* and it was error to dismiss the complaint for lack of jurisdiction on the narrow basis of *Barlow.*

(ii) *Lieberman Is Not Applicable to Jurisdiction of a Federal Common Law Claim*

In *Lieberman, supra,* an employee who had been involuntarily terminated brought an action alleging that the defendant employer was in default in payment of his profit-sharing benefits. Jurisdiction was founded on The Welfare and Pension Plans Disclosure Act, 29 U.S.C.A. § 301, *et seq.* It was held that the latter statute did not provide a civil remedy, and the complaint was dismissed for lack of jurisdiction.

The Court in *Lieberman,* in 343 F. Supp. at p. 561, stated: "Plaintiffs' whole case as set forth in the complaint is based upon an alleged cause of action under this act." There is, again, a clear distinction between that jurisdictional claim and the one at bar. At bar,

plaintiff expressly did *not* claim that either jurisdiction or a remedy existed under § 301. As earlier indicated, the sole purpose of the citation of the federal statutes herein, including § 301, was to demonstrate to the Court a federal statutory scheme with respect to the subject matter of profit-sharing plans in support of the plaintiff's claim that the forfeiture clause of the Plan for competitive employment violated federal common law [8a, 9a]. Although plaintiff herein on the motion below submitted its entire case as to jurisdiction and sufficiency based on federal common law, the Court considered the jurisdiction issue as if it were based directly on a federal statutory remedy giving no recognition to the federal common law claim.

The District Court noted *Lieberman* [56a] as authority for the proposition that the general supervision of such pension plans remains in the state courts absent diversity. *Lieberman* reached that conclusion, as *dicta,* in deciding the narrow question of whether to base direct federal jurisdiction under a disclosure statute of a claim unrelated to disclosure. *Moyer* v. *Kirkpatrick,* 265 F. Supp. 348 (E.D., Pa., 1967), aff'd 387 F2d 955 (3d Circ., 1968), cited in *Lieberman,* which also jurisdictionally dismissed a non-disclosure related claim brought under § 301, made no reference whatever to state court jurisdiction. Certainly, there was no cognizance given in *Lieberman,* or in the Court below, to the formidable 1958 Congressional declaration of the substantial federal concern with these plans in the preamble to § 301. The subject of whether state law would apply to a federal common law claim was not before the Court in either *Lieberman* or *Moyer;* nor a direct question of federal common law, as it was before the Court below. When the issue squarely arose in *Textile Workers* v. *Lincoln Mills, supra,* as to what substantive law to apply with respect to the Labor Management Relations Act of 1957, § 301, 29 U.S.C.A. § 185 (Taft-Hartley Act) where jurisdiction was founded on that statute, but which did not contain a civil remedy for the claim presented, the

Supreme Court decisively held that the substantive law to be applied was federal common law. Mr. Justice Douglas, speaking for the Court, in 353 U.S. at p. 456, stated:

> "The question then is, what is the substantive law to be applied in suits under § 301(a)? *We conclude that the substantive law to apply in suits under § 301(a) is federal law which the courts must fashion from the policy of our national labor laws.* See Mendelsohn, Enforceability of Arbitration Agreements Under Taft-Hartley, § 301, 66 Yale LJ 167. The Labor Management Relations Act expressly furnishes some substantive law. It points out what the parties may not do in certain situations. Other problems will lie in the penumbra of express statutory mandates. Some will lack express statutory sanction but will be solved by looking at the policy of the legislation and fashioning a remedy that will effectuate that policy. The range of judicial inventiveness will be determined by the nature of the problem. See Jackson County v. United States, 308 U.S. 343, 351, 84 L.ed. 313, 317, 60 S.Ct. 285. *Federal interpretation of the federal law will govern, not state law.* Cf. Jerome v. United States, 318 U.S. 101, 104, 87 L.ed. 640, 643, 63 S.Ct. 483. But state law, if compatible with the purpose of § 301, may be resorted to in order to find the rule that will best effectuate the federal policy. See Jackson County v. United States, supra (308 U.S. 351, 352). *Any state law applied, however, will be absorbed as federal law and will not be an independent source of private rights.*
>
> *It is not uncommon for federal courts to fashion federal law where federal rights are concerned.* See Clearfield Trust Co. v. United States, 318 U.S. 363, 366, 367, 87 L.ed. 838, 841, 63 S.Ct. 573; National Metropolitan Bank v. United States, 323 U.S. 454, 89 L.ed. 383, 65 S.Ct. 354. Congress has indicated by § 301(a) the purpose to follow that course

here. There is no constitutional difficulty. Article 3, § 2 extends the judicial power to cases 'arising under . . . the Laws of the United States. . . .' The power of Congress to relate these labor-management controversies under the Commerce Clause is plain. Houston, E. & W.T.R. v. United States, 234 U.S. 342, 58 L.ed. 1341, 34 S.Ct. 833; NLRB v. Jones & L. Steel Corp., 301 U.S. 1, 81 L.ed. 893, 57 S.Ct. 615, 108 ALR 1352. A case or controversy arising under § 301(a) is therefore one within the purview of judicial power as defined in Article 3." (Emphasis added)

In *State of Texas* v. *Parkey,* 441 F.2d 236 (C.A., 10th Circ., 1971), cited favorably by the Supreme Court in *State of Illinois* v. *City of Milwaukee, et al.,* in 406 U.S. at p. 99, it was held that there was original jurisdiction of federal common law claims. In *State of Texas,* at p. 240, it was stated:

"As the field of federal common law has been given necessary expansion into matters of federal concern and relationship (where no applicable federal statute exists, as there does not here), the ecological rights of a State in the improper impairment of them from sources outside the State's own territory, now would and should, we think, be held to be a matter having basis and standard in federal common law and so directly constituting a question arising under the laws of the United States. We agree with Professor Charles Alan Wright that '* * * it should be held that "federal common law", when it exists, is among the "laws of the United States" referred to in the jurisdictional statute, and that except in the admiralty field [see Romero v. International Terminal Operating Co., 358 U.S. 354, 79 S.Ct. 468, 3 L.Ed.2d 368 (1959)] there is federal question jurisdiction based on federal common law'. Wright, Law of Federal Courts, 2d Ed. (1970), § 17, p. 59."

And at p. 241:

> "Federal common law and not the varying common law of the individual States is, we think, entitled and necessary to be recognized as a basis for dealing in uniform standard with the environmental rights of a State against improper impairment by sources outside its domain. The more would this seem to be imperative in the present era of growing concern on the part of a State about its ecological conditions and impairments of them. In the outside sources of such impairment, more conflicting disputes, increasing assertions and proliferating contentions would seem to be inevitable. Until the field has been made the subject of comprehensive legislation or authorized administrative standards, only a federal common law basis can provide an adequate means for dealing with such claims as alleged federal rights. And the logic and practicality of regarding such claims as being entitled to be asserted within the federal-question jurisdiction of § 1331(a) would seem to be self-evident."

With the passage of the Pension Reform Act of 1974 [Employee Retirement Income Security Act of 1974], Public Law 93-406, 93d Congress, H.R. 2, enacted, September 2, 1974, 29 U.S.C.A. 1001, Congress manifested awesome federal concern with pension and profit-sharing abuses, not the least of which was forfeiture of benefits by employees of long tenure in their jobs. This legislation also modified and updated the Congressional concern by amending the provisions of the 1954 Internal Revenue Code and superceding the provisions of the 1958 Welfare and Pension Plans Disclosure Act with more extensive beneficiary protection. This Act represents legislation of the first magnitude. The Act declares the *continued* national involvement expressed in the 1958 Preamble to § 301, and re-states the federal declarations of that existing policy in Sec. 2(a)

with the need for "assuring the equitable character of such plans" on a national basis.

Section 502(e)(1) of that Act, 29 U.S.C.A. 1132, provides that a civil action may [prospectively] be brought by a participant or beneficiary to recover benefits under subsection (a)(1)(B), and for equitable relief under subsection (a)(3). Section 502(e)(1) with respect to jurisdiction of such claims, provides:

> "Except for actions under subsection (a)(1)(B) of this section, the District Courts of the United States, shall have exclusive jurisdiction of civil actions brought by the Secretary or by a participant, beneficiary or fiduciary. State courts of competent jurisdiction and District Courts of the United States shall have concurrent jurisdiction of actions under subsection (a)(1)(B) of this section."

Plaintiff respectfully submits that the Pension Reform Act of 1974 removes any vestige of doubt of federal dominion of the subject matter. Plaintiff submits further that legislation in the area of profit-sharing plans has always been federal, and the 1974 Act is an extension of the specialized federal statutory scheme expressed in the 1958 reporting and disclosure act and the 1954 tax act. Judicial interpretation of the common law claim on this major, substantial and exclusively federal subject matter should therefore give recognition to strong federal public policies.

With respect to jurisdiction of claims for declaratory relief in 28 U.S.C.A. § 2201 of an "affirmative federal right," Professor Mishkin, in his article, stated at p. 178:

> "Here then is the issue: whether the declaratory suit is to be considered as a mode of proceeding in its own right (with all the implications of that view for the problem now before us), or whether it is to be given an effect truncated and limited strictly to the procedural

advantages it may give in suits in any event within the jurisdiction of the federal courts.

Under either approach it seems clear that where the declaration is being sought to establish an affirmative federal right, the suit may be brought in a federal court."

Judge Henry J. Friendly, in his article, "In Praise of *Erie*—and of The New Federal Common Law" (New York University Law Review, Vol. 39, page 383, May, 1964), indicated that "Laws of the United States" described in the Constitution included decisional law as well as statutory law. At p. 392, it is stated:

> "Still more important for our purposes, the 'Laws of the United States' in the judiciary article are not merely federal statutes but substantially the entire law prevailing in the United States. *Any case involving law in that broad sense is therefore a proper subject both for invoking the jurisdiction of the inferior federal courts* and for decision by the Supreme Court on review of state judgments. The Supreme Court would thus be able, indeed was intended, to impose its views in nearly the whole range of private as well as public law." (emphasis supplied)

In respect of construction of the federal labor statutes, Judge Friendly at page 412 stated: "Congress gave a mandate to federal judges to fashion a body of contract law consistent with the policy of federal labor statutes and binding in all courts."

At page 413 Judge Friendly stated:

> "The Lincoln Mills doctrine is pregnant with possibilities. If the grant of federal jurisdiction in suits on labor contracts affecting commerce was a mandate to fashion a federal common law consistent with federal labor legislation, presumably a similar grant of

jurisdiction in suits by stockholders of corporations whose securities are traded in commerce, adorned with a bit of legislative history, would empower the federal courts to fashion a corpus of law on the responsibility of officers and directors consistent with federal securities legislation; and this, like the federal common law of labor, would have supremacy over state law."

At page 414, in a commentary regarding unfair competition affecting interstate commerce, Judge Friendly stated: "Another area which has been largely occupied by federal common law, and where only the smallest bit of legislation is needed for full dominion, is unfair competition in or affecting interstate commerce."

In response to the plaintiff's submission below that profit-sharing plans are creatures of a federal statute, the Court indicated parenthetically [56a] that profit-sharing plans might equally well be argued to be creations of state law by virtue of such statutory provisions as the New York Business Corporation Law, § 202(a)(13) which gives New York Corporations the power to establish and administer such profit-sharing plans. However, federal regulation does not turn on the permissive power provisions of a state corporate charter, it turns on the exercise of those powers in an area of federal concern. At bar, about 5,700 persons in about 35 states (Merrill Lynch's, Prospectus, *supra,* indicates it is a Delaware Corporation) were affected by the overt act of the creation and administration of the trust under federal law. Had the corporation created the trust exclusively under state law, analogous to an intrastate offer of its securities, state public policy alone would govern. It is the trust reaching into an area of substantial federal concern which must answer to federal public policy. Thus, it should not be said that federally-qualified profit-sharing plans are the creation of state law.

The impact of the interstate nature of the registered representatives, activities and Merrill Lynch's own desire to achieve equitable national uniformity in the operation of the PLAN was expressed in its Brief before the Supreme Court in *Ware,* where it is asserted at page 10:

> "The Merrill Lynch Profit Sharing Plan operates *on a national level,* open to all eligible employees wherever located. *Its registered representatives' activities are interstate in nature and contemplate interstate activities. . . .* The net effect of the decision below required compliance with the most stringent standard *in order to achieve desired and equitable uniformity in the operation of the Plan.* State antitrust law does not apply to either the Plan or the employment relationship because of its interstate nature. . . . Section 16600, ostensibly local in operation, is not local in effect and *impedes the uniformity required by the interstate nature of the activities involved.* As such it unduly burdens commerce." (Emphasis added)

The same brief in stressing the interstate nature of the registered representatives' employment, stated at p. 41:

> "Ware's employment was not the typical traditional state regulated local activity. He was expected to service Merrill Lynch clients wherever located and that activity clearly contemplated, as a minimum, use of interstate communication and travel facilities. . . . *Since his employment was interstate in nature as to execution and performance, it cannot be tested by state standards.* That relationship does not admit of diverse treatment since state and local law unduly burden the nature of the enterprise involved." (Emphasis added)

It is respectfully submitted that the District Court statement [56a] that Merrill Lynch's assertion of national

uniformity for wage claims under the federal securities laws was not accepted by the Supreme Court is out of context. The Supreme Court decided that issue in the sphere of federal securities policy. The fact still stands that it was Merrill Lynch's intent in formulating the Plan that it be subject to national uniformity. The Supreme Court's holding with respect to wage claims under federal securities policy is readily distinguishable from wage claims under federal labor policy.

The federal power to legislate with respect to profit-sharing plans is derived from Article I of the Constitution. Therefore, since profit-sharing plans are within the jurisdiction of the Congress to legislate, it should not be said that there is no original subject matter jurisdiction in the federal courts to interpret the provisions of such plans under federal decisional law. The subject matter of construing profit-sharing plans is nowhere exclusively reserved to the states the indications in *Lieberman* notwithstanding For example, in areas of concurrent federal-state jurisdiction such as anti-trust subject matter, either court may contrue its own law. But the federal courts have always construed federal law independent of any state law.

While state courts may be said to have been the usual forum for employer-employee controversies such "usual" jurisdiction cannot deprive the federal courts of the right to construe federal law where federal questions are raised.

Judge Friendly in his Article stated at page 406:

> "There was, to be sure, no logical contradiction between federal judges being free to make their own determinations of 'general' common law for use only in the federal courts, and also 'developing a uniform body of federal decisional rules.' . . ."

At page 407 Judge Friendly also stated:

> "By focusing judicial attention on the nature of the right being enforced, Erie caused the principle

of a specialized federal common law, binding in all courts because of its source, to develop within a quarter century into a powerful unifying force. Just as federal courts now conform to state decisions on issues properly for the states, state courts must conform to federal decisions in areas where Congress, acting within powers granted to it, has manifested, be it ever so lightly, an intention to that end."

The "Study of the Division of Jurisdiction Between State and Federal Courts of The American Law Institute" at Washington, D.C., 1965-1968 indicates that a complaint for a declaratory judgment should be judged on its own merits, and "if it relies on a federal right, then jurisdiction will exist." The same Study, at page 169, states that "federal jurisdiction exists on a federal right if it appears on the face of a well-pleaded complaint."

It is respectfully submitted that the factual allegations of the complaint and particularly the issues presented in paragraph "Twelfth (f) (i) through (vii) [8a, 9a, 10a] present a federal common law claim and satisfy jurisdictional requirements.

It has been held that federal common law is a body of decisional law developed by the federal courts untrammeled by state court decisions, *Lyons* v. *Howard,* 250 F.2d 912, reversed 360 U.S. 593, 79 S.Ct. 1331, 3 L.Ed. 2d 1454 (1959), and that it is not static, but dynamic and adapts itself to changing conditions in society. *Barnes Coal Co.* v. *Retail Coal Merchants Association,* 128 F.2d 645 (C.A. 4th Cir., 1942).

In *Grabinger* v. *Conlisk,* 320 F. Supp. 1213 (N.D. Illinois, 1970) at p. 1217,

> "A. The initial issue of jurisdiction is easily resolved. When a claim is alleged to arise under the Constitution or laws of the United States, the federal district court must entertain the suit except when the alleged claim appears to be immaterial and made

solely for the purpose of obtaining jurisdiction or where it is wholly insubstantial and frivolous. A claim must not be dismissed for lack of jurisdiction unless it appears, to a legal certainty, that the claim is wholly insubstantial and frivolous so far as the Constitution and the laws of the United States are concerned. Bell v. Hood, 327 U.S. 678, 66 S.Ct. 773, 90 L.Ed. 939 (1946). A district court has jurisdiction when the right of a plaintiff to recover under his complaint will be sustained if the Constitution and laws of the United States are given one construction and will be defeated if they are given another. Wheeldin v. Wheeler, 373 U.S. 647, 83 S.Ct. 1441, 10 L.Ed.2d 605 (1963). As plaintiffs' claims are clearly not frivolous, this Court has jurisdiction. Whether the complaint states a cause of action on which relief could be granted is a question of law and just as issues of fact it must be decided after and not before the court has assumed jurisdiction over the controversy." Bell v. Hood, *supra.*

It has also been held that the Court need not adjudicate the merits of the controversy, *The Fair* v. *Kohler Die & Speciality Co.,* 228 U.S. 22 (1913); *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.,* 341 U.S. 246 (1951); *Baker* v. *Carr,* 369 U.S. 186 (1962), but should determine only that the federal claim must be one fairly stated on the merits. *Bell* v. *Hood,* 327 U.S. 678 (1946).

It is thus respectfully submitted that the issues presented herein are substantial and federal in character, and notwithstanding the limited areas of decision in *Lieberman,* federal law will govern federal questions, not state law, provided that the federal question is substantial and is presented in direct reliance on federal law. *McFaddin Express, Inc.* v. *Adley Corp.,* 346 F.2d 424, 426 (2d Cir. 1965); *Baker* v. *Carr,* 369 U.S. 186, 199 (1962); *United*

States v. *Silliman,* 167 F.2d 607, 610-11 (C.A. 3rd Circ. 1948), *cert. denied,* 333 U.S. 825; *United States Fidelity and Guarantee* v. *Hendry,* 391 F.2d 13 (C.A. 5th Circ., 1968); *Montana Catholic Mission* v. *Missoula County,* 200 U.S. 118, 130 (1906).

In summary, plaintiff respectfully submits that the subject matter of profit-sharing plans is federally specialized in character and involved in a major federal statutory scheme, and that jurisdiction exists of a federal common law claim in the absence of an express statutory remedy, and that the Court below erred in holding that the issues herein turned on the *Barlow* and *Lieberman* decisions.

CONCLUSION

For the reasons stated herein, plaintiff requests that the judgment below be reversed.

Dated: New York, New York, March 27, 1975.

Respectfully submitted,

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ADDENDUM

93D CONGRESS
1st Session

REPORT
No. 93-533

HOUSE OF REPRESENTATIVES

EMPLOYEE BENEFIT SECURITY ACT OF 1973

OCTOBER 2, 1973.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

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MR. PERKINS, from the Committee on Education and Labor, submitted the following

REPORT

together with

SUPPLEMENTAL, ADDITIONAL, AND INDIVIDUAL VIEWS

[To accompany H.R. 2]

The Committee on Education and Labor, to whom was referred the bill (H.R. 2) to revise the Welfare and Pension Plans Disclosure Act, having considered the same, report favorably thereon with an amendment and recommend that the bill, as amended, do pass. The amendment substitutes all after the enacting clause and inserts a substitute text which appears in italic type in the reported bill.

I. SYNOPSIS

The Employee Benefit Security Act as reported by the Committee is designed to remedy certain defects in the

private retirement system which limit the effectiveness of the system in providing retirement income security. The primary purpose of the bill is the protection of individual pension rights, but the committee has been constrained to recognize the voluntary nature of private retirement plans. The relative improvements required by this Act have been weighed against the additional burdens to be placed on the system. While modest cost increases are to be anticipated when the Act becomes effective, the adverse impact of these increases have been minimized. Additionally, all of the provisions in the Act have been analysed on the basis of their projected costs in relation to the anticipated benefit to the employee participant. In broad outline, the bill is designed to:

(1) establish equitable standards of plan administration;

(2) mandate minimum standards of plan design with respect to the vesting of plan benefits;

(3) require minimum standards of fiscal responsibility by requiring the amortization of unfunded liabilities;

(4) insure the vested portion of unfunded liabilities against the risk of premature plan termination; and

(5) promote a renewed expansion of private retirement plans and increase the number of participants receiving private retirement benefits.

Provision is made for the imposition of criminal penalties on those willfully violating their duties under the Act. The Labor Department is given primary authority to administer the provisions of the Act, but the Committee has placed the principal focus of the enforcement effort on anticipated civil litigation to be initiated by the Secretary of Labor as well as participants and beneficiaries.

II. Background

The private pension system is a relatively modern economic institution tracing its role as an important social and economic factor only from the mid 1940's. A variety of converging financial and social trends in our society have created a favorable environment for the growth and expansion of private deferred compensation schemes and retirement programs in general. As our economy has matured, an ever increasing number of employers have recognized their responsibility for the physical and economic welfare of their employees, even for the years beyond retirement. Its development parallels and is a response to the transition of the American life style from its rural agrarian antecedents into its present urbanized, wage earner society. The dynamic asset growth necessary to meet its responsibilities has placed the private pension system in a position to influence the level of savings, the operation of our capital markets, and the relative financial security of millions of consumers, three of the fundamental elements of our national economic security.

The growth of the private pension movement in the United States proceeded slowly until the years preceding World War II. As the full implications of the economic changes sweeping the nation were felt, American beliefs and attitudes regarding retirement security changed. The passage of the Railroad Retirement Act and the Social Security Act marked the turning point in American thinking, and dissatisfaction with those early govermental programs contributed to an accelerated interest in private retirement plans. The wage freezes imposed during World War II and the Korean conflict focused increased attention on the deferred component of compensation as a means of avoiding the freeze restrictions.

In 1947 a series of administrative proceedings and court decisions under the National Labor Relations Act of 1935

held that pensions were a form of remuneration for the purposes of that Act, and they accordingly became mandatory subjects of collective bargaining. (Inland Steel Company v. NLRB, 170 F.2d 247 (7th Cir. 1948), cert. denied, 336 U.S. 960 (1949)). In the same time period a Presidential fact finding commission in presenting its report on the steel industry labor dispute in 1949 stated that:

> We think all industry in the absence of adequate Government programs, owes an obligation to workers to provide for maintenance of the human body in the form of medical and similar benefits and full depreciation in the form of old age retirement—in the same way as it now does for plant and machinery.

In 1940, an estimated four million employees were covered by private pension plans; in 1950, the figure had increased to almost 10 million and in 1960 over 21 million were covered. Currently, over 30 million employees or almost one half of the private non-farm work force are covered by these plans. This phenomenal expansion of coverage has been matched by an even more startling accumulation of assets to back the benefit structure. Today, in excess of $150 billion in assets are held in reserve to pay benefits credited to private plan participants.

This rapid growth has constituted the basis for legislative efforts at both the federal and state levels to assure equitable and fair administration of all pension plans.

Various aspects of pension plans have been affected to some degree by most of the major labor legislation of the twentieth century, including the National Labor Relations Act (1935), the Labor Management Relations Act (1947), and the Labor Management Reporting and Disclosure Act (1959). However, not until 1958, with the enactment of the Welfare and Pension Plans Disclosure Act, was legislation effected which was specifically designed to exercise regulatory controls over pension and welfare funds. Based upon disclosure of malfeasance and improper activities by

pension administrators, trustees, or fiduciaries, the Act was amended in 1962 to designate certain acts of conduct as federal crimes when they occurred in connection with welfare and pension plans. The amendments also conferred investigatory and various regulatory powers upon the Secretary over pension and welfare funds. In the decade since the amendments were enacted, experience has shown that, despite intermittent enforcement of the reporting requirements and the criminal provisions, the protection accomplished by statute has not been sufficient to accomplish Congressional intent.

The Existing Law

The growth and development of the private pension system in the past two decades has been substantial. Yet, regulation of the private system's scope and operation has been minimal and its effectiveness a matter of debate. The assets of private plans, estimated to be in excess of $150 billion, constitute the only large private accumulation of funds which have escaped the imprimatur of effective federal regulation.

At the federal level, there are essentially three federal statutes which, although accomplishing different purposes and vested within different federal departments for enforcement, are all compatible in their regulatory responsibilities. These are the Welfare and Pension Plans Disclosure Act (29 U.S.C. Sec. 301 et seq.), the Labor Management Relations Act (29 U.S.C. Sec. 141, et seq.) and the Internal Revenue Code I.R.C. of 1954, Secs. 401-404, 501-503.

A complete description of the federal regulation affecting the administration of private plans can be found in Interim Report of The Private Welfare and Pension Plan Study, 1971, Senate Report No. 92-634 of the 92d Congress 2d Session.

After a comprehensive investigation of abuses in the administration and investment of private fund assets, Congress adopted the Welfare and Pension Plan Disclosure Act in 1958. The policy underlying enactment of this Act was purportedly to protect the interest of welfare and pension plan participants and beneficiaries through disclosure of information with respect to such plans. The essential requirement of the Act was that the plan administrator compile file with the Secretary of Labor, and send to participants and their beneficiaries upon written request, a description and annual report of the plan. It was expected that the knowledge thus disseminated would enable participants to police their plans. The Act was amended in 1962 to make theft, embezzlement, bribery, and kickbacks federal crimes if they occur in connection with welfare and pension plans. The 1962 amendments also conferred limited investigatory and regulatory powers upon the Secretary of Labor, and required bonding of plan officials.

Experience in the decade since the passage of the above amendments has demonstrated the inadequacy of the Welfare and Pension Plans Disclosure Act in regulating the private pension system for the purpose of protecting rights and benefits due to workers. It is weak in its limited disclosure requirements and wholly lacking in substantive fiduciary standards. Its chief procedural weakness can be found in its reliance upon the initiative of the individual employee to police the management of his plan.

The Labor Management Relations Act, Sec. 302, provides the fundamental guidelines for the establishment and operation of pension funds administered jointly by an employer and a union. The Act is not intended to establish nor does it provide standards for the preservation of vested benefits, funding adequacy, security of investment, or fiduciary conduct.

Tax deduction benefits accruing to employers are prescribed by the Internal Revenue Code under which the employer is granted a deduction within certain limits for contributions made to a qualified plan, and the investment earnings on such plans are made tax-exempt. To attain "qualified status" under the Code, the plan must be (1) for the exclusive benefit of the participants; (2) for the purpose of distributing the corpus or income to the participants; (3) established in such a manner to make it impossible for the employer to use or divert funds before satisfying the plan's liabilities; and (4) not discriminate in favor of officers, stockholders, or highly-compensated or supervisory employees.

The Internal Revenue Code provides only limited safeguards for the security of anticipated benefit rights in private plans since its primary functions are designed to produce revenue and to prevent evasion of tax obligations. The essence of enforcement under the Code lies in the power of the Internal Revenue Service to grant or disallow qualified status to a pension plan, thus determining the availability of statutory tax advantages. The Internal Revenue Service jurisdiction and enforcement capabilities are solely to allow various tax advantages to accrue to employers who establish and maintain pension plans which can qualify for such tax benefit privileges.

In the absence of adequate federal standards, the participant is left to rely on the traditional equitable remedies of the common law of trusts. A few states, including New York, Washington, Wisconsin, Massachusetts, and California have codified existing trust principles and enacted legislation which requires in many instances a degree of disclosure similar to that required by federal statute.

The fact that statutory rules exist says little as to their efficacy in adjusting inequities that are visited upon plan participants, as evidenced by the hearings before this Committee. In almost every instance, participants lose their

benefits not because of some violation of federal law, but rather because of the manner in which the plan is executed with respect to its contractual requirements of vesting or funding. Courts strictly interpret the plan indenture and are reluctant to apply concepts of equitable relief or to disregard technical document wording. Thus, under present law, accumulated pension credits can be lost even when separated employees are within a few months, or even days, of qualifying for retirement.

The proposed bill would, therefore, establish minimum standards of vesting, funding, and fiduciary and a system of compulsory benefit insurance to protect the security of pension rights.

As suggested by the President's Cabinet Committee Report of 1965; "As a matter of equity and fair treatment an employee covered by a pension plan is entitled, after a reasonable period of service, to protection of his future retirement benefit against any termination of his employment." Concern for loss of benefits by workers after long years of labor through circumstances beyond their control was similarly expressed by President Richard M. Nixon on December 8, 1971, when, in a message to the Congress he said, "When a pension plan is terminated, an employee participating in it can lose all or a part of the benefits which he has long been relying on, even if his plan is fully vested . . . even one worker whose retirement security is destroyed by the termination of a plan is one too many."

(57805)

United States Court of Appeals
for the Second Circuit

75-7100

William H, Nolan, on behalf of himself and
all Others similarly situated,
Plaintiff- Appellant,

v.

Bernard B. Meyer, Carl Antenucci, Steve Narker et al.,

Defendants-Appellees.

AFFIDAVIT OF SERVICE

STATE OF NEW YORK,
COUNTY OF NEW YORK, ss.:

Juan Delgado , being duly sworn, deposes and says that he is over the age of 18 years, is not a party to the action, and resides at 596 Riverside Drive, New York, New York
That on March 28, 1975 , he served 2 copies of Brief and Appendix
on

Brown, Wood, Fuller, Caldwell & Ivey, Esqs.,
Attorneys for Defendants-Appellees,
One Liberty Plaza,
New York, New York

by delivering to and leaving same with a proper person or persons in charge of the office or offices at the above address or addresses during the usual business hours of said day.

Juan A. Delgado

Sworn to before me this 28
day of March , 1975

John V. Desposito
JOHN V. D'ESPOSITO
Notary Public, State of New York
No. 30-[illegible]
Qualified in Nassau County
Commission Expires March 30, 1975